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economic Review

The War Everyone Won

It has been exactly a year since the NATO aggression on Yugoslavia. All parties in the conflict claim victory. But, in fact, they switched goals, pretending to have gained whatever they had wanted from the very beginning. With a little help from propaganda, this could be sold out easily. The problem is that such a policy does not lead towards a solution to the crisis.

The regime in Belgrade has had only one goal from the onset of the country's breakup - to remain in power. People in the regime have come to power with a pretence of defending the interests of the Serbs in Kosovo, and during the NATO aggression they managed to remain in power as they actually defended Kosovo by the military. They lost Kosovo and one insolvable problem along with it, but they have maintained the credibility of their policy towards Kosovo. That enables them to still remain in power.

It appears that the prevailing goal of the international community was to end the Balkan crisis once and for all, which had started with the separation and early recognition of Slovenia. That goal was not reached, but a humanitarian problem of refugees emerged in the meantime, giving additional legitimacy to military intervention.

The Albanians in Kosovo wanted an independent state and at that time it appeared to be their last chance. They did not get it, but are now free from Belgrade's influence. Supported by the international community, they will realize their goal more easily. Problems like drug trafficking and local military commanders who are beyond civilian control still remain.

The Serbs in Serbia had no wish to live in Kosovo, but were willing to die for it. That is not easily understood without some knowledge of history. The long-lasting process of the country's disintegration only increased their wish to prevent any further change of borders. They failed to

FRY Basic Economic Indicators	1999	1999 1998	II 2000	II 2000 I 2000	II 2000 II 1999	I-II 2000 I-II 1999
GDP - USD million	14.224a)	-19.3%	...	...	...	...
Montenegro	...	...	...	...	...	...
Serbia	...	...	...	...	...	...
GDP per capita - USD	1.699a)	-19.1%	...	...	...	...
Montenegro	...	...	...	...	...	...
Serbia	...	...	...	...	...	...
Central Serbia	...	...	...	...	...	...
Vojvodina	...	...	...	...	...	...
Industrial Production	...	-24.1%	...	20.7%	-5.1%	-8.9%
Montenegro	...	-7.6%	...	-1.9%	-8.1%	-4.5%
Serbia	...	-25.6%	...	22.4%	-4.9%	-10.7%
Central Serbia	...	-24.5%	...	19.1%	-2.8%	-7.9%
Vojvodina	...	-28.2%	...	31.4%	-9.4%	-16.8%
Average Wage - DM	107	-31.7%	85	0.7%	-33.3%	-34.0%
Montenegro	154	-14.1%	158	7.4%	-5.2%	-3.9%
Serbia	102	-33.8%	80	-0.2%	-36.3%	-37.0%
Unemployment Rate	27.3%	8.3%	...	...	...	...
Montenegro	36.8%	7.9%	...	...	...	...
Serbia	26.5%	8.2%	27.1%	1.1%	...	...
Export - USD million	1.498	-46.9%	112.0	8.0%	-27.4%	-35.6%
Montenegro	123	-4.7%	6.5	-63.9%	-21.2%	21.0%
Serbia	1.375	-48.9%	105.0	23.1%	-28.1%	-37.0%
Import - USD million	3.296	-30.3%	244.0	-19.8%	-13.4%	-16.1%
Montenegro	358	6.9%	13.0	-44.0%	-39.7%	-43.8%
Serbia	2.938	-33.2%	230.0	-17.8%	-11.2%	-12.9%
Monetary supply (M1), end of period, DIN billion	16.4	51.9%	17.2	4.2%	53.7%	52.3%
Cash	6.7	34.0%	6.0	-1.6%	27.7%	31.5%
Deposits	9.7	67.2%	11.2	7.7%	72.3%	67.4%
Real money supply, end of period, DM million	739	-42.3%	686	-2.7%	-42.4%	-42.7%
Market exchange rate, monthly level	4.25%	-38.8%	4.55%	12.6%	-33.3%	-38.02%
Retail prices	...	42.4%	...	1.8%	52.6%	52.4%
Montenegro	...	60.1%	...	2.8%	132.0%	131.1%
Serbia	...	41.1%	...	1.6%	47.8%	47.7%
Cost of living	...	44.9%	...	2.2%	60.8%	60.2%
Montenegro	...	67.2%	...	4.0%	145.8%	144.8%
Serbia	...	43.5%	...	2.0%	54.9%	54.3%
Industrial prices	...	44.2%	...	...	...	...
Montenegro	...	63.7%	...	...	...	...
Serbia	...	43.2%	...	...	...	...
Black market exchange rate (din/DM)	12.6	88.1%	21.0	5.0%	134.1%	137.7%

a) Official statistics, without Kosovo, unreliable

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accomplish that, but there will be no more changes of borders after the Kosovo conflict. The Serbs in Kosovo required protection. Instead, they became refugees or subject to permanent attacks and mistreatment. They are the only ones who claim no victory in the war.

Kosovo Serbs are the only ones who claim no victory

NATO was intended to play the role of the Rambouillet Accords implementer, but the sequence of events placed its credibility in focus. That crisis of credibility demanded intervention more than security or humanitarian reasons. The alliance's unity has been preserved, but for the first time such one-sided action was conducted outside of the defensive alliance and without prior UN consent. Consequences were unexpected. The war was victorious and NATO was de facto enlarged to all neighboring countries - far before it was expected or desired.

Prior to the intervention, the Yugoslav Army was completely suppressed by the police. It failed to defend the country's territorial integrity, although it bravely entered the war against a much stronger enemy. It lost the war, but regained dignity and respect thanks to low-ranking officers, not the generals. The regime will now try to discredit the army again in internal political conflicts, which will contribute to further disintegration within the country.

Part of the opposition intended to use the Kosovo problem as a means to participate in the government and prove themselves capable of resolving serious state problems. Instead, it was proved that cooperation with the regime could exist only by serving its daily interests. However, the opposition is left with a possibility to become victorious at the forthcoming elections if it demonstrates itself to be a credible alternative to the government. To achieve that, it is not sufficient to become united in a single list, the opposition must also offer solutions to the citizens' concrete problems. Kosovo is only a part of that story.

Futile hopes and statements

June 10, 2000 marks the anniversary of the adoption of UN Security Council Resolution 1244 on Kosovo. It will be extended by automatically, as it requires the Security Council to vote unanimously for its cancellation in order to suspend its extension. The Yugoslav authorities' expectation that somebody will vote against extension in the Security Council is completely out of the question as, even in that case, the Resolution will be extended for another year.

Claims of the Yugoslav generals on an immanent return to Kosovo are also out of the question. Even in the case of an agreed return, as foreseen by the Resolution, but without any precise date, it will involve only several hundred policemen, personnel for marking & clearing minefields, liaison officers and customs officials.

Resolution 1244 will be extended

The Yugoslav authorities are right to complain that the UN Resolution paragraph on territorial integrity and sovereignty of the FRY has not been respected. Nevertheless, they ignore the fact that this paragraph is always related to the paragraph on “full respect” of the Rambouillet Accords.

To understand this claim we have to go back to the beginning of the disintegration of the former Yugoslavia. That was an atypical case in international relations. Therefore, an atypical solution was applied. It contains three key moments:

1. The approach of the Badintaire Commission which granted the right to separation to formerly Yugoslav republics and stipulated that the internal administrative borders would become external state borders. That was not set out in the Helsinki Final Act.

2. The Dayton Accord modified this precedent. One republic was granted the right to become an independent state, but it was temporarily placed under international protectorate.

3. Within a new state, nationally homogenous “entities” were formed so as to maintain the multiethnic character of the whole state.

Yugoslavia has never ratified the Dayton Accord, but it signed and recognized it de facto. The Rambouillet Accord is a copy of the Dayton Accord by its principles. This accord was not signed by the Yugoslav party, but UN Resolution 1244 lent it legal force. The Yugoslav party has accepted the Resolution, thereby signing the Rambouillet Accords indirectly.

According to the Resolution, the international community has taken on the obligation to control borders, provide for the full security of all citizens, the peaceful and safe return of all refugees, economic reconstruction, and the creation of democratic institutions within the broad principle of self-government for Kosovo. Local elections will be held next fall followed by elections for Kosovo's parliament later next year.

Necessary democratic institutions

Meanwhile, it is necessary to establish democratic self-governing institutions. The Rambouillet Accords will serve as a basis for that. UN Resolution 1244 uses the expression “taking full account of the Rambouillet Accords,” which grants certain liberty in its implementation. The most important change should refer to Article 8, which allows the change of municipal borders, but only on the basis of a decision by the Kosovo Parliament. The situation concerning the Serbs' security is such that certain municipal borders should be changed even before the Kosovo Parliament is established, thus providing regional self-governance for the Serbs. Unless this occurs, municipal elections will fail to contribute to calming the situation in Kosovo.

Only democratic changes will hold Kosovo in Serbia

That is one condition. The other refers to KFOR's commitment to provide for the security of all citizens in Kosovo, in accordance with Paragraph 9 (c) and (d) of the Resolution. The challenge will probably emerge in the summer when around 60,000 refugees are expected to move from Preshevo to Kosovo and the territory primarily inhabited by Serbs. The third legitimate request originates from Paragraph 9 (g) of the Resolution on efficient border monitoring duties. It presumes the prevention of the KLA from entering the south Serbian territory. The fourth request refers to Paragraph 9 (b) and Paragraph 15 on requirements for demilitarization of the KLA. Conflicts in south Serbia prove that KFOR has so far failed to demilitarize the KLA completely.

The opposition's requests for strict respect of UN Resolution 1244 are both legitimate and useful, but not sufficient. Implementation of the Resolution assumes the establishment of democratic institutions before a political accord on the final status of Kosovo is reached. If the opposition wishes to become actively involved in this process, it should do everything possible to win the elections. Only democratic changes will improve the negotiating position of Serbia, offering realistic prospects that the territorial integrity and sovereignty of Yugoslavia will be preserved at the future international conference on Kosovo.

The Public Revenue System in Serbia - Flight from Market Orientation

If today a poll were to be conducted among citizens in Serbia on whether they consider the tax system just, most of them would probably give a negative answer. That would, of course, not represent a specific Serbian feature, nor could it be evidence in itself of the population's political disposition. The old warning of Berk that "A human being cannot be taxed and satisfied, just like it cannot love and keep a sane mind", can be applied in large measure even to developed countries, with long parliamentary tradition and efficient budget control.

The tax system in Serbia is characterized by circumstance in which citizens seldom have an opportunity to pay public duties directly: the share of these payments in total public revenue amounts to only about 10%. As opposed to all OECD member countries, and most countries undergoing transition, there is no global (synthetic) income tax in Serbia, one that is determined by decision of a competent tax authority and based on information from the citizens' tax reports. That tax, ranked first by bulk in the taxation structure, has been replaced by schedular taxes on specific types of income, among which the tax on wages is predominant (82.5% of total collected schedular taxes). Since earnings are agreed upon in net amounts, the personal income tax (as well as the contribution to social insurance charged to employees) is actually shifted to the employer. In fact, a complementary annual citizens' income tax was introduced in 1999, and charged, along with an obligatory submission of tax returns, to natural persons whose annual net income surpassed 72,000 dinars (120,000 dinars today). However, due to the high untaxed minimum and the fact that many potential taxpayers pay flat-rate taxes or have cash (thus unregistered) income, the complementary tax role becomes negligible. Citizens have direct taxpaying obligations only with respect to taxes on income based on personal labor, agriculture, forestry, and corresponding contributions to social insurance, as well as to part of the tax on capital gain and property, dues, compensation for the use of city land property, compensation for the use of public goods, and customs duties. All other taxes, contributions, dues and compensations are paid by legal persons – as direct obligations, as taxpayers in the case of duties paid after deductions, or as obligations that burden the end consumer with indirect taxes.

Income tax is paid by the employer

Although I estimate that various forms of public revenue accounted for around 55% of the GDP (measured according to net material product methodology) in 1999, citizens in Serbia do not have a clear picture of what taxes touch their lives as a result of complex processes shifting the tax burden via the market (i.e. whose available income really decrease due to a tax). On the other hand, there is a widespread sentiment that the fiscal system is unjust.

Diagnosis

Radical fiscal reform was conducted in Serbia at the beginning of the nineties, with the intention of introducing a public revenue system that would correspond to systems of taxation in OECD member countries. It encompassed:

- Replacing the existing system of schedular taxes (and corresponding contributions) on specific types of revenue, with a global (synthetic) income tax;
- Introducing contributions to compulsory social insurance (paid by both employees and employers) to finance old-age pensions, health insurance, and unemployment insurance;
- Introducing taxes on corporate capital gain, in place of the Organization of Associated Labor income tax (later to become the company income tax), which would later be partly integrated with the citizens' income tax through mechanisms of relief for stockholders, in by deductions of 50% on the value of received dividends from the base taxable income;
- Exempting excises on oil, oil derivatives, tobacco products, alcoholic beverages, coffee, luxury goods, etc., from the scope of turnover taxes, and a subsequent reduction of the number of taxation rates to two (instead of the former several tens);
- Abolition of existing tax privileges (exemptions, relief, special tax regimes, differentiated tax rates, etc.), to extend the tax bases and enable a reduction in tax rates.

A replacement of the existing turnover tax in end consumption with a value added tax (VAT) was also anticipated, however that aspect of the tax reform was postponed until 1995 due to the necessity of appropriate administrative and technical preparations.

After eight years of operation, the public revenue system in Serbia can be described by the following features:

1. Instability. The occurrence of changes in tax legislation and sub legislative regulations is surprisingly frequent, even when all the dramatic political, economic, and social circumstances which marked Serbian society in the course of the nineties are taken into consideration. For example, the Law on Income Tax of citizens changed 26 times in the 1992-1999 period (averaging 3.25 times annually), with the schedular system applied initially instead of the global one, giving way in 1999 to a "steady" application of the mixed taxation model (schedular taxes plus a complementary progressive tax for taxpayers with extremely high annual net revenue). Regarding the turnover tax, the irregularity of tax policy had two manifestations: the number of tax rates increased with time (from two to four), while surtaxes multiplied (first the railroad tax was introduced, then the 3% city tax, followed by the federal tax for financing defense of the country). In the case of contributions to compulsory social insurance, initially the whole matter had been settled by one law, then it was transferred to a corresponding system of laws so that organizations for compulsory social insurance were authorized to determine the contributions' rates. This was followed by regulations on assumed bases for accounting contributions (depending on the employee's degree of education, not their actual income), while certain employers had the opportunity to calculate contributions at 50% of the base. There are many more examples of similar straying, with many unfavorable consequences for investors with regard to the uncertainty of conditions in business management.

A striking frequency of changes to regulations

2. Distortion of tax structure. The portion of particular tax forms in the structure of public revenues of a country depends upon many factors (economic development, the degree of openness and market orientation of the economy, governmental organization, market-governed flexibility of certain taxes, etc.). In OECD member countries as a whole, income tax has the most significant role (23%), followed by contributions to social insurance (22%). The turnover tax (in the form of a VAT in all OECD member countries except the USA and Australia) accounts for 16% of public revenue, while 11% is provided by excises and customs duties. Corporate income taxes account for 8% of public revenue, while 5% comes from property taxes. The portions of taxes on the use of public goods and taxes on payrolls are marginal (2% and 1% respectively), while non-tax instruments

1] Croatia, Czech, Estonia, Hungary, Latvia, FYROM, Moldavia, Poland, Russia, Slovakia, Slovenia, and Ukraine.

2] Transfers in the form of reciprocated payment of contributions among specific organizations of compulsory social insurance are excluded from public revenue. If contributions to compulsory social insurance and taxes on payrolls, paid by the state in the role of employer, were also excluded, with a conservative estimate that the share of duties where the state is the employer-debtor amounts to 12% of total like duties, then public revenue would have amounted to 52,6% of GDP in Serbia.

(dues, penalties, private law state revenues) account for around 12% of public revenue.

In Serbia, income taxes (schedular income taxes, daily allowances for solidarity, and contributions comprise 12% of public revenue – half that of OECD member countries. Contributions to compulsory social insurance comprise 36% of public revenue, more than 60% above the OECD average. The absence of a global progressive income tax, the low personal income tax rate (14%), a significantly lower per capita GDP, and the large scope of the black market economy (where income tax is not paid), are several factors that account for the fairly small participation of income tax in the structure of public revenues in Serbia. On the other hand, social contributions represent the most abundant duty in the system, while the fact that their share in the structure of public revenues is three times that of the income tax can be partially understood by considering that social contributions burden incomes with the unusually high rate – 53.2%. Around 47,5% of public revenue in Serbia comes from the taxation of labor, mainly due to the role of contributions to compulsory social insurance. The strain upon labor is even larger when indirect taxes (turnover taxes, excises, etc.) are taken into consideration, which shift per definitionem to the end consumers.

Social taxes are the biggest source of revenue

The share of company income tax in the public revenue structure in Serbia is 1% - eight times less than in OECD member countries - which demonstrates not only the bad state of the Serbian economy, but also that regulations have enabled an erosion of the tax base.

The share of property taxes (taxes on real estate and land, capital levies, death duties, gift taxes, taxes on the transfer of absolute rights, dues and solidarity contributions for transactions in payment operations) in the public revenue structure in Serbia recorded large growth in 1999, after the mentioned dues and contributions were introduced with a collective rate of 0.3%. It marked an increase from 2% to 3%, but remained lower than the OECD average of 5%.

Turnover taxes (on goods and services operations, the federal sales tax for the financing of defense, railroad tax and a 3% city tax) have a 23% share in Serbian public revenue relative to a 16% chare in OECD member countries. This can be explained not only by the fact that the share of indirect taxes in the public revenue system of a country is, generally, larger as per capita GDP falls, but also by the fact that the collective standard turnover tax rate in Serbia reaches 30%, while the average standard VAT rate in OECD member countries is around 18% - a little more than the lower collective turnover tax rate in Serbia (which is 17%). However, it is curious that the share of excises (including various compensations for oil and oil derivatives, alcoholic beverages, and cigarettes) and customs duties is almost equal, though as per the general correlation of a larger share of indirect taxes in underdeveloped countries, it should have been larger in Serbia. This discrepancy alludes to the very large scope of contraband activities.

The share of taxes on the use of goods (taxes on cellular phones, weapons and motor vehicles, compensations for the use of city land, compensations for the use of public goods, exit fees for traveling abroad) is 50% larger in Serbia than in OECD member countries, while the share of taxes on payrolls (communal compensation, housing contribution) is 200% larger.

A large scope of contraband

Various fees (court, administrative, and communal), penalties and private law public revenues have a 7% share in the public revenue structure in Serbia, as compared to the 12% share they have in the public revenue structure of OECD member countries.

3. Non-neutrality. It is an open question as to whether the socialist regime in Serbia ever believed in an authentic market economy. However, the tax reform of 1991 was conceived as a framework for conducting a largely neutral tax policy, which centered on an abolition of existing tax relief. The system retained incentives that were closely related to certain criteria (e.g. foreign investment stimulation, capital market development, improvement of ecological conditions, etc.). By the end of the decade, instead of a market economy, the goal was apparently set on establishing a command economy, which called for a totally different tax policy – one that would stifle the process of market allocation. Many a tax relief was gradually built into the tax system favoring specific branches of economic activity, even specific taxpayers, and discriminating against all the rest. I will mention only some of the most distinctive non-neutral features:

Stifling efficient market allocation

- the standard turnover tax rate on certain products of domestic manufacture (cosmetics and hygiene items, shoes, clothes, underwear, personal cars up to 1.2-1.4 liters active volume) was halved by government decree. Thus, contrary to the rules of GATT (now WTO), imported articles were discriminated against;
- long-term capital gain achieved by legal persons is taxed at half the amount of long-term capital gain by natural persons;
- the daily allowance for solidarity was applied only to personal income (and not all at that) and pensions, so that natural persons who obtain other forms of income are thus favored. Moreover, in defining the tax rate for this duty, the legislature opted for so-called global progression (where rates fall within the scope of 3.85% and 23.08%), which leads to the strange effect that a taxpayer earning 1 dinar more than the set limit between two tax units (installments) must to pay the higher rate with respect to the whole amount earned;
- around two thirds of taxpayers pay a lump sum on income from independent economic activity, which does not reflect the real economic power of the entrepreneur in a majority of cases;
- specific employers are allowed to calculate contributions to social insurance, which is their burden, at 50% of the established base;
- tax authorities have the discretion to approve postponement of arrears for certain taxpayers.

4. Unjustness. Two basic criteria have developed in financial literature for estimating the degree of justness in tax policy. Namely, taxes must provide: a) horizontal justness, which implies that taxpayers of equal economic potential should be equally burdened with tax, and b) vertical justness, which implies that taxpayers of larger economic power should pay higher taxes.

Two forms of tax evasion

Horizontal equality has been disrupted by numerous cases of exemption from the taxation regime which have been implemented by law or executive decree. The problem becomes more acute when accounting for the fact that around 40% of GDP is produced in the black market. Two forms of tax evasion mark this sector.

The first form is standard in nature and can be encountered in almost all countries (to a smaller or larger extent): it concerns taxpayers who violate regulations in different ways. The ones who abide by regulations, however, are subject to harsh – and unjust – taxation. Moreover, they are obliged to immediately deposit their daily cash earnings to a business account, and allowed to withdraw only an amount that does not surpass USD 10 in dinars daily.

The second form of tax evasion is characteristic of societies where the rule of law is weak, and public interest is not differentiated from private interest. Certain members of the nomenclature engage in illegal activities of wide scope (cigarettes, alcoholic beverages, oil derivatives), and in other forms of “grey” or “black” activities (street currency market, pegging, etc.) with approval from the authorities. It is not a rare case that the Payments Bureau (ZOP) is given directives by phone to release untaxed income for privileged indebted taxpayers. Tax moral erodes completely in such an environment, while selective campaigns of the Financial Police against taxpayers that incline towards evasion are more a warning of the danger of political abuse over public revenue control than measures to increase the scope of payments. Sometimes we have to wonder about the underlying motives of certain taxation policy measures. For example, at the end of 1999 there was a drastic decrease of excise tax on tobacco products (from 70%, 50%, and 40% to 4%) and hard liquors (from 30% to 3%, and from 50% to 4%). Simultaneously, these items were transferred to the group of items with a lower collective turnover tax rate (17% instead of 30%). Such solutions led to the paradox that the excise on beer became 3,3 times, and the excise on wine 66,67% higher than the excise on brandy. These measures were intended as a blow to cigarette and hard liquor contraband from Montenegro or abroad into Serbia, which indeed became less profitable. However, it is questionable whether these kinds of measures - which lessened excises on tobacco and hard liquor to an extent that is hardly encountered anywhere else in the world - can be sustained in the taxation system for long.

The Law on Special Conditions and Clearing Fiscal Arrears further eroded the tax base, disrupted horizontal equality and undermined tax ethics. Its solutions are discriminatory in two ways. Firstly, they amnesty all taxpayers that fall into the so-called “economic category” of their due and unpaid tax debts and of the 100% interest rate on tax debt. On the other hand, the Government retains the right to grant tax amnesty and more favorable conditions (undefined by law) to either public, or other kinds of companies, according to its own preference. Taxpayers that have duly paid their tax obligations are left under the impression that they made a serious mistake: respecting the law does not pay in this country. Thus it can be expected that this regulation will encourage both law-abiding and non-abiding taxpayers to forgo paying arrears in the future.

Limited actions against smuggling

Vertical equality cannot be accomplished until the existing system of schedular tax is replaced by a global (synthetic) income tax for natural persons. Presently, proportional taxes are dominant with the exception of the daily allowance for solidarity. As mentioned above, a complementary progressive annual income tax was introduced for the first time in 1999. However, the high untaxable minimum resulted in a fairly small number of taxpayers and a negligible effect of the tax. Since progressive income taxation for natural persons makes sense only if it is widely applied, in terms of both the public and its own provisions , I can conclude that its role is not fulfilled in Serbia. Distribution of the tax burden, after introducing daily allowances for solidarity and the annual income tax, is more or less accidental: some social groups (e.g. those with large income) are drastically affected, while others – of equal or larger economic potential but a different income structure – get by more favorably.

5. Non-transparency. The public revenue system in Serbia is marked by outstanding non-transparency, characteristic of non-market economies.

Firstly, in choosing forms of taxation, comparability with tax systems of countries with developed market economies was not achieved. The fiscal reform in 1991 was based on the postulate of achieving such comparability. Although a synthetic (global) income tax was introduced in 1991, its implementation was systematically postponed up until 1998 (schedular tax was used in the meantime), when it was abolished and replaced by today’s mixed model of citizens’ income taxation. Our public revenue system does not have a VAT. The initial plan for its implementation in 1995 was postponed until 2001. Along with Bosnia and Herzegovina, the FR of Yugoslavia remains the only European country that does not apply a VAT as a form of turnover tax. Meanwhile, the single-phase retail turnover tax is kept, while the number of tax rates increased from two to four. Calculating contributions to social insurance has become extraordinarily complicated since 1997.

Delayed introduction of a proportional tax

Secondly, the public revenue system has become extremely fragmented. While the Law on Public Revenue and Expenditure initially listed public duties that had been approved, in time, by way of special laws and even sublegal enactments new forms of public revenue were introduced to the system which made the relevant provisions of the Law on Public Revenue and Expenditure “a dead letter.” There are now three surtaxes on the existing turnover tax (for financing railroads, defense of the country, and the city tax in Belgrade), various “compensations” for oil derivatives, cigarettes and alcoholic beverages, “contributions” and “fees” on transactions in payment operations, the compensation for use of radio and TV channel frequencies, the daily solidarity allowance, etc. As many as 230 different taxes, contributions, fees, and compensations are in my database at the moment, and it is possible that new ones will be added.

Thirdly, non-transparency of the public revenue system in Serbia is reflected by numerous tax privileges and special regimes imposed by law, sublegal enactments, and even unofficial instructions. The tendency is clear: in order to achieve a certain economic and political goal, the Government prefers the use of tax expenditures to budget subsidies, conscious that tax expenditure is, by its nature, less conspicuous than direct public expenditure which should be exposed in the budget. Hence, the real scope of privileges granted to certain taxpayers remains concealed from the general public.

A fragmented system conceals privileges

Further development

No changes to these unfavorable tendencies in fiscal policy are expected while the present ruling coalition holds a majority in parliament. The main features of the public revenue system – instability, non-neutrality, non-transparency and unjustness – will not alter. The first three are the best examples of the distance we keep from a market model.

It can be expected with considerable certainty that the implementation of the federal Law on a VAT will be postponed (it will not be applicable on Montenegrin territory, also, tax administration was never formed on the federal level, nor does it – in the case of Serbia – dispose of the informative and technical base needed to administer a VAT). No changes are to be expected in the domain of citizens’ income tax either, since the current basically schedular system with proportional tax rates protects interests of the nomenclature, while the complementary annual income tax has a demagogic role: nominally, there exists progressive taxation, although the scope of this tax is, in fact, minor.

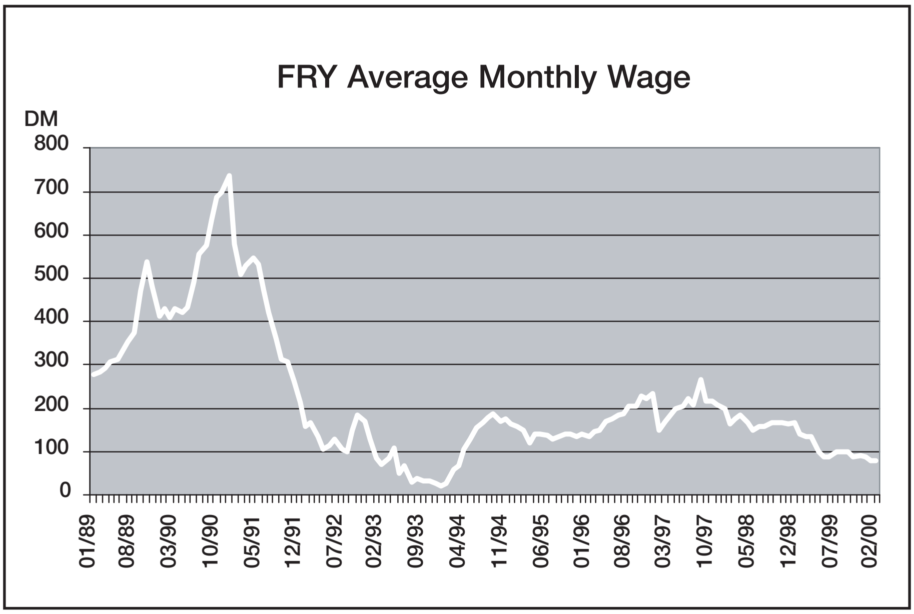
I am convinced that the practice of introducing various “compensations” and “fees” on different products will continue with the revenue used for covering deficits in the pension fund and maybe even the social security fund. Also, the number of new tax forms, especially the destined ones, will increase even further. The policy of selective tax relief will continue, to favor certain privileged taxpayers while the fiscal burden will fall upon others, however inconspicuous, who should be discriminated against as per the assessment of the authorities. When the Government concludes that the desired effects have been achieved, that the blows directed to smugglers – in Montenegro or outsiders within the republic – of hard liquor and cigarettes have been productive, an increase of excise rates on these items can be expected. All in all, I am of the opinion that the existing structure of public revenues will be preserved and dominated by fiscal solutions that mostly affect labor and that the total participation of public revenue in GDP will persist at the level of around 55%.

Continued introduction of new "compensations" and "fees"

3] The annual income tax does not include interest rates, capital gain, lottery prizes, and income from agriculture and forestry, while dividends were subject to three-fold taxation in 1999 (up to 90%), then freed from taxation in 2000. The daily solidarity allowance is applied only to certain kinds of wages, and pensions.
4] Contrary to the constitution, which allows the implementation of public duties by law only. See: Art.64 of the Constitution of the FRY, and Art.52 of the Constitution of Serbia.
5] By the end of March 2000, a special compensation on beer was introduced by decree of the Government of Serbia.

Macroeconomic Review

Existing contradictions in economic policy were exacerbated in February while price controls postponed a statistical rise of inflation. A low tariff burden and rather unrealistic official exchange rate has modified the import structure. These movements in import will have effects on domestic production in the months to follow. The high monthly growth of industrial production becomes relative, when compared to the same period last year. Money supply has grown due to an increase of deposits, thus explaining the rise of the giro rate.



Prices and wages

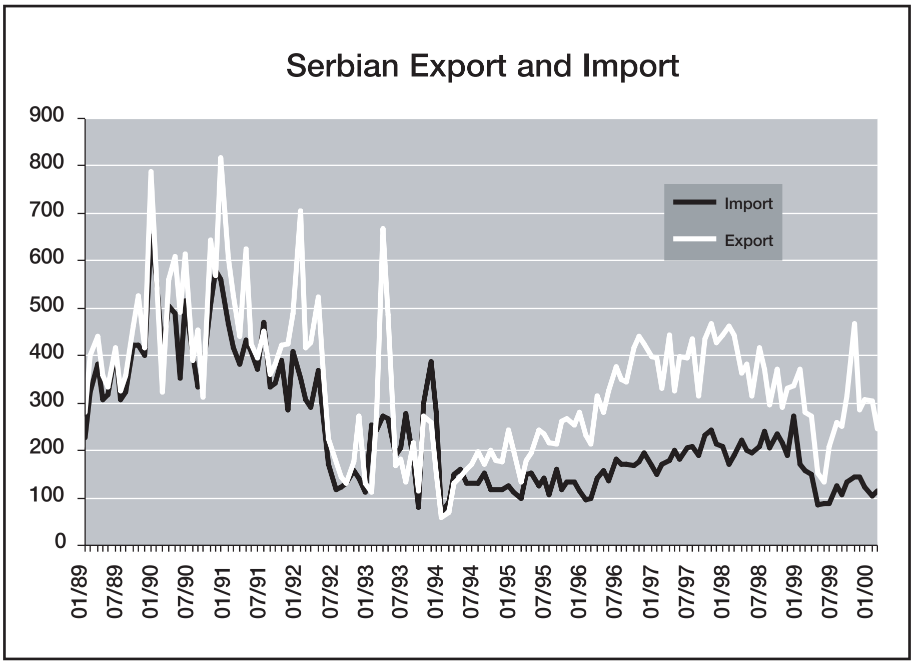
Retail price growth in Serbia was 1.6% in February and 2.8% in Montenegro month-on-month. In the case of Montenegro, the growth of retail prices is dropping off after several months of sharp inflation. This follows the acquisition of alternative sources of supply following an embargo imposed by Serbia. Market conditions have thereby stabilized to a certain extent. Nevertheless, the structure of price inflation produced faster growth in living expenses. Living costs in February rose by 2% in Serbia and by 4% in Montenegro month-on-month.

At first glance, low retail price growth in Serbia can not possibly correspond to reality. The prices of oil derivatives were unfrozen in February and recorded a growth of 80%. Yet, according to official statistics for February, liquid fuels and oils contributed the most to movements of the total price index (around 7%), but marked a monthly price growth of only 0.95%. The answer to these contradictory statistics is simple: the price growth in oil derivatives occurred after the end of price recording, so it was not included in the government's price index accounting. A similar situation was later repeated with the price of medicinal products, which recorded a decrease in February of 2.6% in the territory of FRY. After incorporating the actual price growth of oil derivatives and medication, two-digit inflation in March should be expected. Once March inflation statistics are released in-full those who think inflation which does not appear in statistical reports does not exist will have their illusions shattered. Even so, the release of complete government statistics on March will reveal only a part of repressed inflation.

The average monthly wage in Montenegro was 158 DM/mo in February, almost twice the wage in Serbia, which was 80 DM/mo.

Industry

Industrial production in FRY rose by 20.7% month-on-month in February. In Montenegro it dropped by 1.9%, while in Serbia it rose by 22.4%. In Serbia proper production rose by 19.1%, and in Vojvodina by 31.4% month-on-month. It is interesting that production fell in only 5 sectors – the power industry (-8.5%), oil and gas production (-6.2%), iron production (-5.5%), tobacco production and processing (-2.0%) and coal production (-1.0%). All other sectors marked an increase, ranging from +0.9% (shipbuilding) to +136.8% (wood processing). This is quite strong growth, even considering the seasonal upswing of production in February following the shortened number of working days in January.



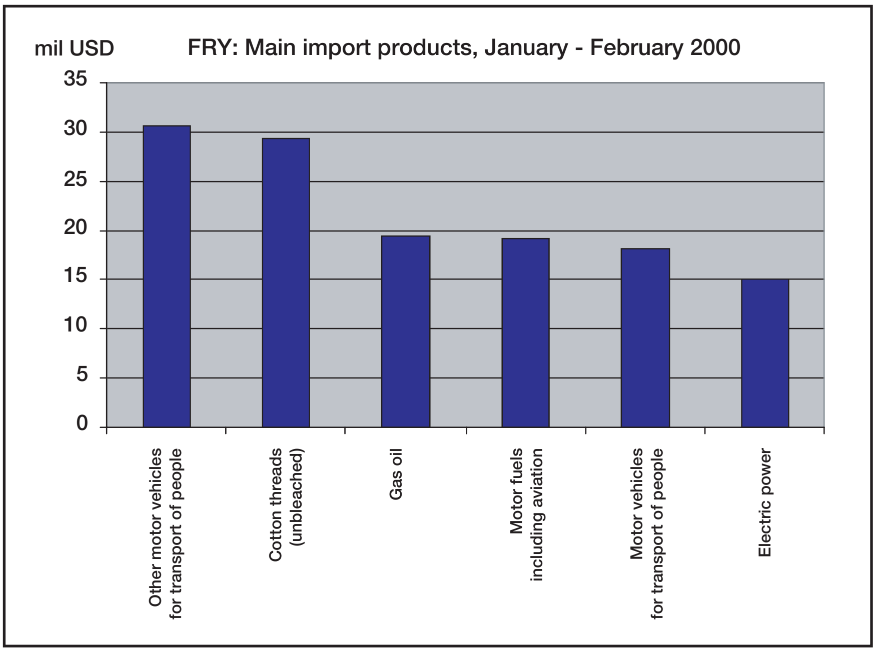
However, FRY's industrial production remains 5.1% down from February, 1999 and down by 67.9% compared to that of February, 1989. In Montenegro, production is down 8.1% year-on-year and down in Serbia 4.9% year-on-year. In central Serbia production fell by 4.9% year-on-year and fell in Vojvodina by 9.4% year-on-year. Using the so-called level index, which mitigates the effects of accidental factors on the rise and fall of production by averaging down the monthly indices, we can confirm the real fall of production.

According to this more realistic indicator, the decline in production was somewhat less in Montenegro at -4.5% than that in Serbia at -10.7%. In central Serbia production was down 7.9% and down by 16.8% in Vojvodina. Fifteen sectors showed growth relative to February of last year - ranging from +1.3% in the power industry to +69.0% in wood processing, while 20 sectors recorded a decline, ranging from -49.1% in the chemical industry to -1.8% in coal production.

Foreign trade

In February, Serbian exports amounted to USD 112 million, two thirds of the export value as that seen in the same period last year (-36.9%), while imports registered at USD 244 million, a 12.3% drop year-on-year. The trade deficit in February was USD 132 million, while the cumulative deficit for the first two months of 2000 stood at USD 333 million.

Relative to last year, the import structure has changed considerably as the import of consumer goods rose in both relative and absolute terms. The cumulative value of consumer goods imports was USD 233 million in February, compared to USD 184 million in the same period last year.

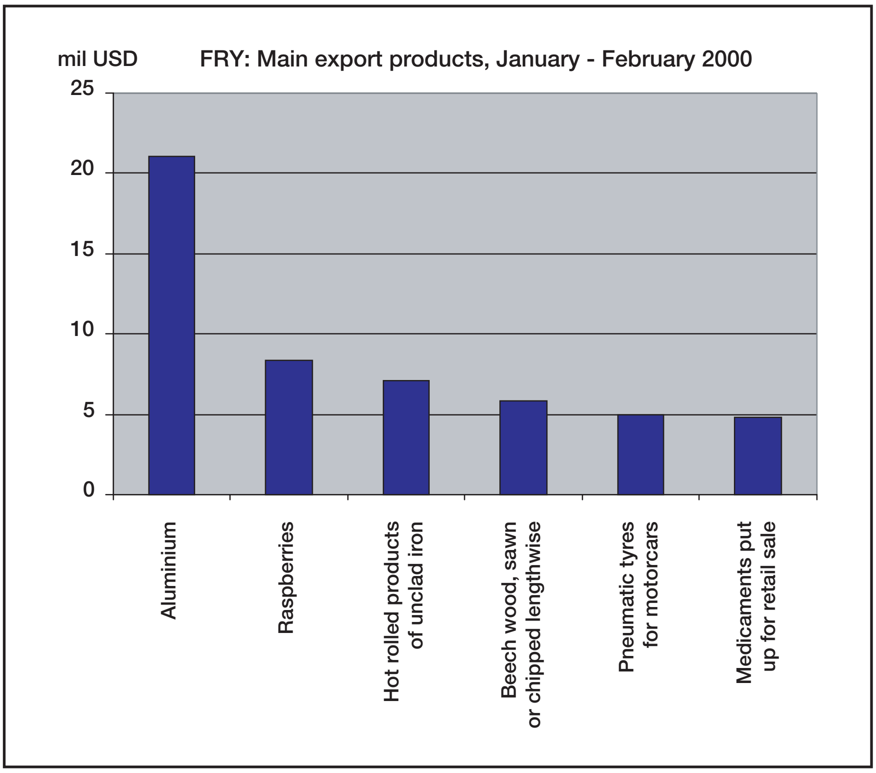


This shift resulted from favorable conditions for import. Those who import consumer goods use low tariffs and avoid price control. In nominal terms, tariff rates are far from low. Tariff rates are on the price expressed in dinars calculated at the official exchange rate. The standard tariff rate is 40% plus a 1% customs notifications fee. Tariffs can be modified (i.e. increased by 2.5 times) for certain goods under a regime of contingencies, bringing rates to as high as 101%. However, given the large discrepancy between official and parallel exchange rates, the real tariff burden accounts for around 22%.

In a context where foreign currency is sought by all means – even where export is not economically justified – the export market is highly fragmented. Production in FRY is highly dependent on the import of raw materials and advanced technology, but exporters often use hard currency earned on export for the more lucrative import of consumer goods. High growth rates are anticipated in the months to come, largely due to the last year's low basis point. Yet, the rising trade deficit – primarily based in consumer non-durables – is certain to reflect negatively on the rate of growth in domestic production.

Administrative and quantitative restrictions aimed at reducing these pressures are no longer in operation. It appears that the situation in foreign trade is similar to that of price control. The long-lasting denial of reality and the regular rescheduling of concrete reform measures have exacerbated the problem to an extent that fear of the consequences of change postpones any solution to the problem.

A low tariff on auto imports (12%) and inflationary expectations brought auto imports to first place in total import value. The import of oil derivatives saw a large increase (+132.8%), accounted for by both structural and seasonal variables. Bulgaria is by far the largest single source of oil derivatives, magnifying its position in the FRY commercial trade portfolio of late. In contrast to January, when electricity was primarily imported from BiH & comprised the largest portion of total import from that country (49.1%), no further imports of electricity from BiH were registered in February.



Montenegrin exports rose by 21% in February relative to the same period last year, while imports fell by 43.7%. The import of oil derivatives was reduced by 40.8% year-on-year in Montenegro.

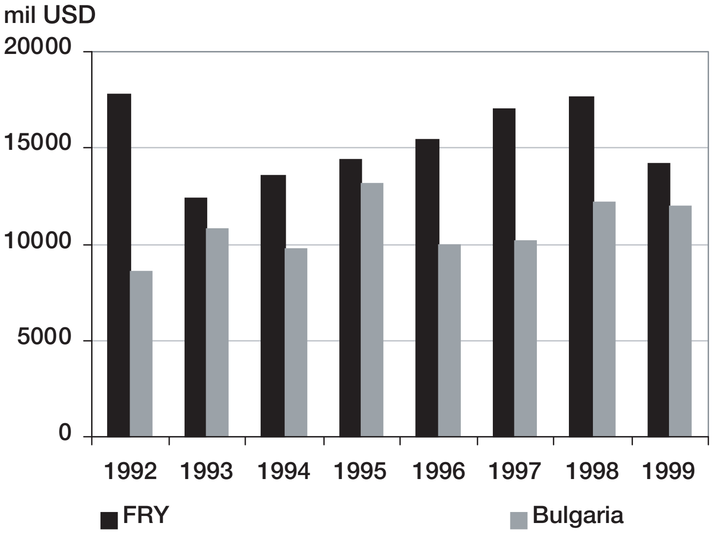
It is worth mentioning that according to official figures, there was no natural gas imported in January or February. How revisions to these figures will transform our analysis is yet to be seen. Nevertheless, it is certain that if there are no significant changes in the management of foreign trade policy or official currency rates, the rising trade deficit will place increasing – perhaps unsustainable – pressure in the already strained dinar's value.

Monetary movements

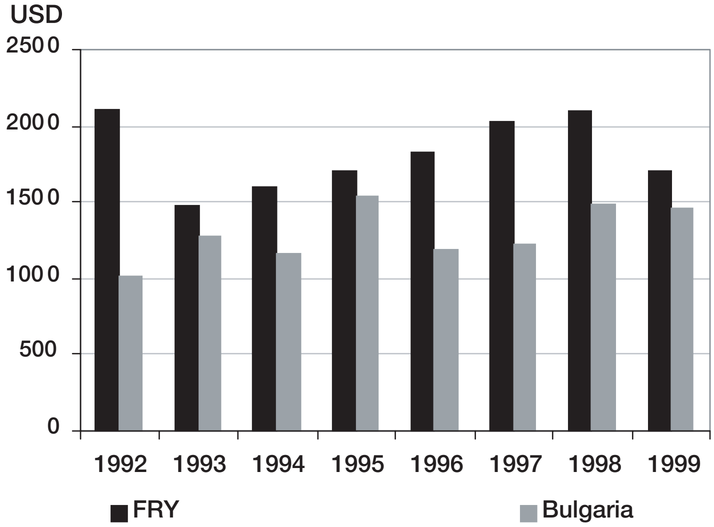
Money supply (M1) in February was around 17 billion dinars, reaching at one point the level of 17.4 billion dinars. This means that money supply rose by almost one billion dinars within the last two months. What then explains the relatively limited movement of the black market rate (+10%)? The answer is in the changing structure of M1. Specifically, deposits rose by 1.7 billion dinars in February while cash holdings dropped by around 700 million dinars. This is reflected in the movement of the black market and giro rates. The giro rate reached 29din/DM by the end of March, following the movement of deposits, while the premium black market rate rose by a smaller degree. In line with the rising black market exchange rate, real money supply continues to decline, registering at DM 686 million in February, relative to 705 million in January of this year.

Yugoslavia in the mirror of Eastern Europe

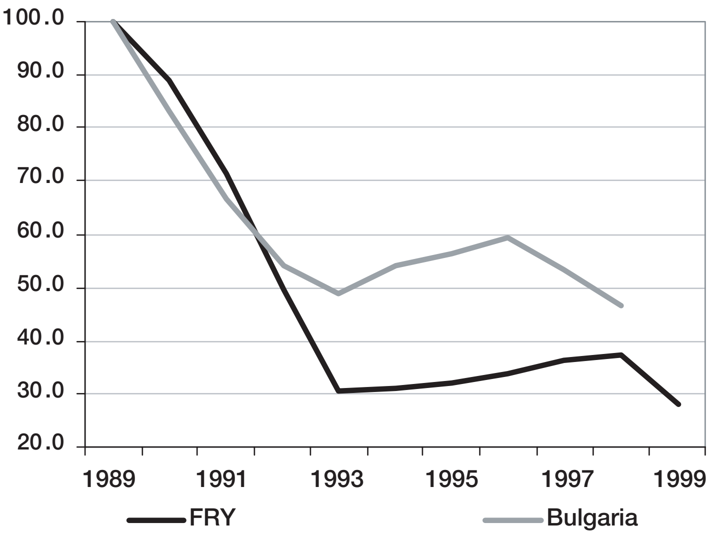
GDP



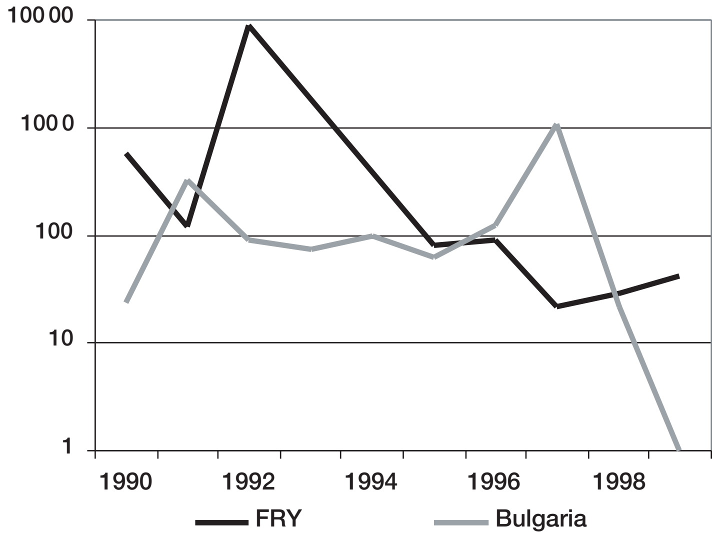
GDP per capita



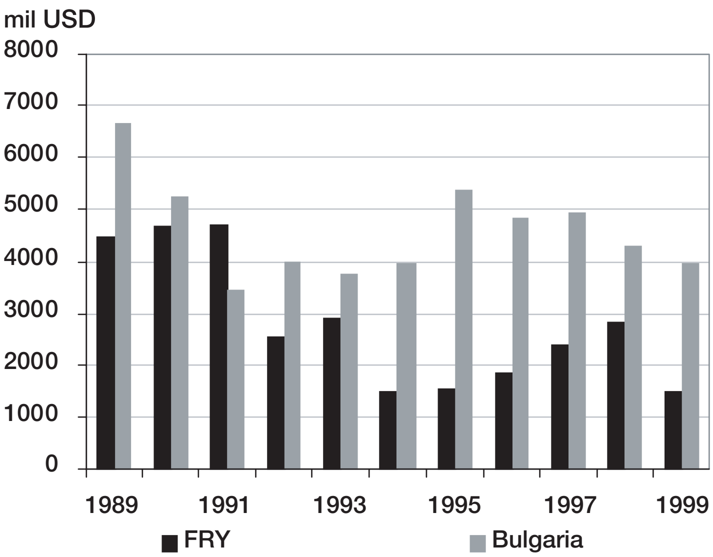
Industrial Production (1989=100)



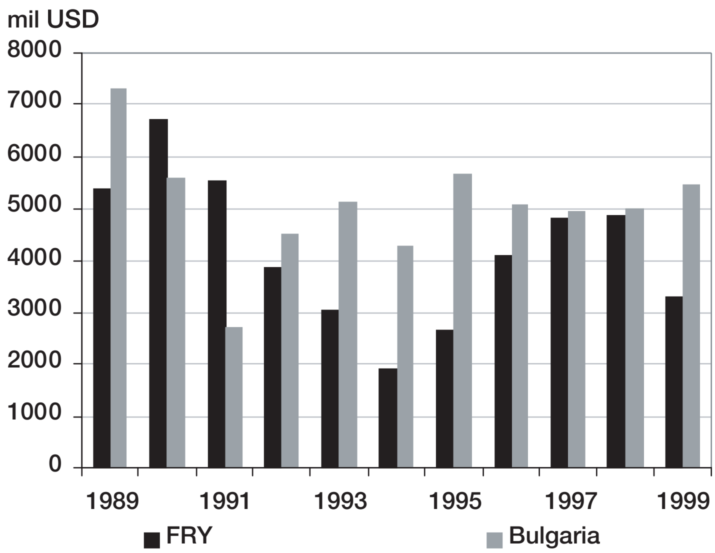
Annual Rate of Inflation



Import



Export



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